Testimony of Robert C. Baugh
Executive Director AFL-CIO Industrial Union Council
and Chair AFL-CIO Energy Task Force
Before the Environment and Public Works Committee of the U.S. Senate
November 13, 2007

Chairman Boxer, on behalf of the 9 million members of the AFL-CIO, I want to thank you and the members of the Environment and Public Works Committee for the opportunity to testify this afternoon on America's Climate Security Act (S. 2191).

America needs an energy policy for the twenty first century that will result in a cleaner planet, greater energy efficiency and the revitalization of our manufacturing base. It is an opportunity for our nation to prove that economic development and environmental progress can and should go hand-in-hand. We believe that taking action to address global warming and energy independence are mutually reinforcing goals that are in the best interest of the nation's economic, environmental and national security.

The AFL-CIO has actively participated in various stakeholder meetings with members of both the House of Representatives and the Senate that have led to legislative proposals that the AFL-CIO and many of our affiliates have supported. We have also participated openly and honestly in the stakeholder meetings that resulted in S. 2191, America's Climate Security Act. It is our intention to continue working with the members of this committee to develop "cap-and-trade" legislation that addresses the environmental health of the planet while assuring that good paying jobs are not sacrificed to overseas competition.

The AFL-CIO takes to heart the statement in S. 2191 that this legislation should achieve its purpose "while preserving robust growth in the United States economy and avoiding the imposition of hardship on United States citizens." Today we wish to recognize the aspects of S. 2191 that the AFL-CIO supports and to offer our thoughts on how to strengthen the legislation.

Investment Portfolio

We appreciate the fact that the original draft of S. 2191 incorporated many of our investment recommendations such as the inclusion of bonus allowances to promote early technology deployment and the early auction of allowances for quick investment into research and development. We commend Senator Lieberman and Senator Warner for their original draft of S. 2191 which made critical long term commitments to technology development and deployment with an investment portfolio that includes renewable energy supplies, appliance efficiency, biomass, advanced coal and sequestration program, and the advanced technology vehicles manufacturing incentive program.

Unfortunately, the latter two pieces of the investment portfolio were severely undermined by automobile and coal-related amendments adopted during the subcommittee markup. The AFL-CIO believes these amendments are counterproductive and actually undermine the technological transition this legislation is attempting to achieve. We encourage the committee to return to the original language

Timelines and Targets

The AFL-CIO supports realistic timelines and goals for emission reduction. We are concerned that there is a disconnect between the reduction targets and the actual development and deployment of new technology. S2191 set a 15 percent reduction of greenhouse gas emissions below 2005 levels by 2020. This is prior to the anticipated commercial availability of carbon capture and storage technologies. Similarly, renewable technologies have their own set of technology development and deployment issues that seriously call into question the ability to meet the reduction levels without drastic economic harm.

S. 2191 also requires a 70 percent national emission reduction below 2005 levels by 2050. The AFL-CIO has supported a 60 percent or greater reduction by 2050 that was tied to a Presidential review of the participation of the developing nations like China, India, Brazil, etc in a global climate protection framework. We urge the Committee to also make this linkage and include five-year review requirement.

Job Creation

We believe that S. 2191 can serve a dual purpose: environmental protection and economic development. The legislation needs to make explicit the implicit economic development goals embodied in the bill's investment strategy and its stated purpose of "preserving robust growth." It is in the national interest to assure that the investment dollars generated by this legislation are reinvested in our domestic economy.

We urge the Committee to adopt language to direct the Climate Change Credit Corporation that "the financial resources of the corporation shall be dedicated to domestic investments. In addition, we suggest that "domestic economic development" be identified as a finding of Congress and that domestic investments in technology development, production and construction" be identified as a purpose of the legislation.

Cost Control and the Market System

The AFL-CIO supports a limited market approach to cap and trade, with regulatory mechanisms that act as a price control to prevent any serious long-term damage to the economy. The Carbon Market Efficiency Board (CMEB) has a cost control mechanism,

but we believe its market intervention tool and its open market system work at cross-purposes.

The CMEB is empowered to take action after prolonged allowance price hikes of 180 or more days but that may be too late because firms are required to obtain and use allowances annually. In 180 days the irreparable economic damage will already have been done. Additionally, the intervention tool allowing the issuance of "future" allowances to drop prices seems to be of limited value given how this market seems to be structured.

S. 2191's open and "unlimited trading" of allowances and the ability to bank them in perpetuity leaves the system open to predatory and speculative trading practices and the hoarding of allowances that will fuel volatile pricing in the market. This will have a detrimental pricing impact on the public, utilities sector, and energy-intensive industries.

To address these concerns, the AFL-CIO recommends that the trading of allowances be regulated and restricted. Market participation should be limited to firms that intend to use the allowances. The banking of allowances be limited by setting a "time certain" by which they must be used or expire. These steps will help create a more certain less speculative trading environment. In addition, the CMEB market intervention timeline should be shortened and additional intervention tools considered.

International Provisions

The AFL-CIO endorses S. 2191's inclusion of international language which will help preserve American jobs while taking an important step forward to engaging the developing world in seeking a solution to global warming. However, modest modifications to the international timeline and implementation process would strengthen this section.

Implementation can and should take place far sooner than 2020. The bill should require the President to open negotiations immediately upon enactment. Once the regulations are in place and the cap and trade program is in operation for two to three years, then the international action can be implemented. This last step should be an administrative action, not something subject to presidential waiver.

Offsets and International Allowances

We are concerned about the use of offsets and international allowances; the ability to monitor their legitimacy; and ways in which they could undermine domestic investment in industry. Under S. 2191, for up to 30 percent of the annual allowances a firm must submit be comprised of offsets (15 percent) and internationally purchased allowances (15 percent). This could prove to be a disincentive to firm investments in transformational technology.

The AFL-CIO believes that the S 2191 should either limit the use of offsets and international allowances in combination, or simply to lower the amount available. We also have a related concern over the possibility of double dipping, whereby allowances are granted for offset activity that would have been done anyway as a course of law, tax policy and/or business practice. This does not add to green house gas reduction and should be prohibited.

We look forward to working with Congress to achieve an energy policy for the twenty-first century that will result in a cleaner planet, greater energy efficiency, and the revitalization of our manufacturing base.

An appendix accompanies this testimony that provides additional information about our testimony.

Appendix: AFL-CIO Recommendations for America's Climate Security Act

The Investment Portfolio

Advanced Technology Vehicles Manufacturing Incentive Program

As previously indicated, the AFL-CIO strongly supports the thrust of the Advanced Technology Vehicles Manufacturing Incentive Program created under S. 2191. This program can help to accelerate the introduction of advanced technology vehicles, and thus to help our country make major strides in reducing greenhouse gas emissions and our dependence on foreign oil. At the same time, it can ensure that the vehicles of the future are built in this country, thereby creating tens of thousands of jobs for American workers.

However, we believe the language in these provisions needs to be improved in several respects. First, the language in Section 4405(b)(1) should be modified to clarify that awards under the program can only be made to manufacturers and components suppliers for re-equipping or expanding a manufacturing facility "in the United States" to produce qualifying advanced technology vehicles and components. Obviously, we should not be providing funds to subsidize investment in manufacturing facilities in other countries.

Second, during the Subcommittee markup, an amendment by Sen. Sanders was adopted by voice vote that requires all qualifying advanced technology vehicles to meet a 35 miles per gallon standard to be eligible for assistance under this program. Unfortunately, this amendment totally eviscerates the program. In order to make meaningful progress in reducing our dependence on foreign oil and greenhouse gas emissions, the auto industry needs to improve fuel economy across the entire spectrum of vehicles. It needs to put hybrid and advanced diesel technology into pickups, sports utility vehicles (SUVs), minivans, and larger passenger cars, as well as smaller vehicles like the Prius.

Indeed, some of the greatest gains in reduced oil consumption and greenhouse gas emissions can come from improving the fuel economy of these bigger vehicles. However, because many of these vehicles would still be below the 35 miles per gallon level, even with the hybrid or diesel advanced technology, the Sanders amendment would effectively exclude them from being able to get any assistance under the manufacturing program. As a result, this would greatly reduce the effectiveness of the program in achieving the environmental goals, as well as its ability to generate jobs for American workers.

It is also important to note that the Sanders amendment directly conflicts with the CAFE provisions that were approved earlier this year by the Senate in the energy legislation, and that were supported by environmental groups. Those CAFE provisions specified that the fleet of vehicles for the entire industry must meet a 35 miles per gallon standard, not that each and every vehicle must meet this standard. Indeed, under the reformed, attribute-based CAFE system approved by the Senate, it was expressly recognized that different

sizes and types of vehicles would have to achieve different fuel economy levels, depending on their particular attributes. Unfortunately, the Sanders amendment departs from this approach, and instead imposes a rigid, one-size-fits-all mandate on all vehicles.

Finally, Section 4405(c)(1) specifies that the manufacturing incentive program only applies to facilities and equipment placed in service before January 1, 2016. In our judgment, this time period is far too restrictive, especially since the CAFE provisions previously approved by the Senate have a far longer time period, stretching to 2020 and beyond.

Subcommittee Amendment: Coal Preference

We are concerned about the amendment approved by the Subcommittee concerning preferences for "low rank" coals with a heat content less than 10,000 BTU/pound. There should be no distinction among coal types in allowance allocations to electric generating units, or the distribution of auction revenues as incentives to promote clean coal technologies. This sets up a regional preference for coal.

This was a major flaw in the EPA's Clean Air Mercury Rule, which awarded extra allowances to low-rank western lignite and sub-bituminous coals, despite a growing body of evidence that controlling mercury from these coals costs substantially less than from eastern bituminous coals. While there are minor differences in the CO2 emissions of coals of different rank, CO2 emissions can be captured by a variety of emerging control technologies potentially applicable to all coal types at both new and existing units.

We believe that all coals should compete for incentives on a level playing field without regional preferences or exemptions. The bill should remain as originally drafted.

Timelines and Targets

Our most serious concern is the magnitude and timing of 2020 reductions (15 percent below 2005) compared to Bingaman-Specter (2006 levels). Reductions on the coal fired power generation will come from investments in increased efficiency in existing facilities, new IGCC (combined cycle technology that is only in the early developmental phase with a demonstration plant scheduled to be built in Ohio), and the development of carbon sequestration technology. Full development of these latter technologies will take a decade, and deployment to scale will take decades more.

There is insufficient time to develop and demonstrate CCS technology at commercial scale. 2020 is effectively 5 years from now in terms of corporate planning for investments. Meeting 2006 levels by 2020 is a major reduction given 1 percent population growth and 2-3 percent GDP growth. The bill suggests that the annual

reviews will allow adjustments of the targets, but experience with the Clean Air Act does not support this view.

Job Creation

Economic Development and Domestic Investment

This legislation does have a dual purpose: environmental protection and economic development. The legislation needs to make explicit the implicit economic development goals embodied in the bill's investment strategy and its stated purpose of "preserving robust growth." We believe that this is in the national interest, and it is the intent of Congress to assure that investment dollars generated by this legislation recirculate in our domestic economy. The legislation needs to say so.

To fulfill its dual purpose, this legislation needs to promote domestic investment as an economic development strategy that runs from R&D to production and construction. The findings, purpose, and Climate Change Corp. sections need to be explicit about this intent. For example:

- Finding: "The Congress finds prompt and decisive domestic climate change investments are an unprecedented economic development opportunity for the nation.

- Purpose: "to accomplish that purpose by making climate change investments in domestic technology development, production, and construction."

- Climate Change Credit Corporation: "the financial resources of the corporation shall be dedicated to domestic investments so as to assure that the nation derives the maximum economic development return from those investments;

    - Climate Change Credit Corporation domestic investment program will be designed to capture intellectual property, encourage industry development, and to retain and create new jobs in production, construction and conservation of energy.

    - Existing facilities and populated areas shall be considered a strategic priority for manufacturing-related investments.

    - Energy incentives and investments by the federal government must not encourage off-shoring of manufacturing or the sale of assets.

    - The Climate Change Credit Corporation will report to Congress on an annual basis about the domestic economic and environmental impact of its investments."

Cost Control and Market Systems

Safety Valves and Market Intervention

The AFL-CIO supported the cost control mechanism (the Technology Accelerator Payment) in the Bingaman-Specter bill because it provides pricing certainty for long-term investment decisions, assures a modest effect on fuel and electricity prices, and avoids short-term price spikes that can lead to fuel-switching. In this case, the legislation also sets a beginning price of $12 per ton that rises 5 percent a year above inflation. *We are open to discussing alternative levels of a safety valve price.*

The proposed Carbon Market Efficiency Board (CMEB) also attempts to act as a cost control mechanism, but its open market system undermines this approach and its intervention tool is at best slow and of questionable value. The CMEB is empowered to act in cases where there are prolonged price hikes in allowances (180 or more days) that threaten economic damage to the nation. The CMEB will also have to determine what that "sweet spot" (price) is. With limited allowances that firms need to use annually, in 180 days the damage will already have been done. The issuance of "future" allowances to drop prices seems to be of dubious value and of real concern given how this market is structured.

Allowance borrowing from the future is not likely to work due to uncertainty about future allowance prices. With a $10 current price, utilities would not borrow 10 years ahead unless there were certainties that prices would not be above $25 at that time (using a typical utility weighted average cost of capital of 9.5 per cent).

Cap and Trade and the Open Market

We remain deeply troubled with a simple market-only approach. Today the so-called market has left the nation in a housing crisis and the world capital markets in turmoil. The nation is still dealing with the fallout of Enron and the deregulation of the utility industry, which will make any carbon emission legislation even more difficult to administer. We support a limited market approach, with regulatory mechanisms that act as a safety valve to prevent any serious long-term damage to the economy. If the point of a cap and trade system is to move firms and utilities to change domestic behavior, then we need to be sure this market mechanism does that.

The open and "unlimited trading" of allowances means that anyone, not just firms that need to use them, can buy allowances from a limited and declining pool. In addition, purchasers are allowed to bank these allowances in perpetuity. This is not the stock market or a commodities market, nor should it be treated as such. The open access to allowances, and the banking of allowances, lend themselves to the kind of predatory and speculative behavior that leads to hoarding and to the creation of carbon billionaires.

This would have a detrimental pricing impact on the public and the utilities and energy-intensive industries.

Imagine a scenario in which a major nation with over a trillion dollars in accumulated trade surpluses decides to create a carbon allowance shortage on the U.S. market to make our domestic firms less competitive and push them out of business. Or imagine a major hedge fund trying to corner the carbon market and to extract royalties from domestic industry. With limited allowances, one would only have to capture a limited portion to have control. That is not the intent of this legislation. This needs to be regulated:

- The trading of allowances should be regulated and should be done in such a way that it assures that allowances that are sold are used. In other words, market participants should be limited to firms that intend to use the allowances. With a declining pool of allowances, available prices will rise but not be artificially inflated by speculators.

- The banking of allowance for an unlimited time raises the same concerns about hoarding and predatory behavior that leads to price spikes and artificially elevated prices. If the point is to use a diminishing allowance system to effect real behavior change and to have a functioning market that fairly sets prices, then allowances need to have a deadline by which they must be used or expire.

International Provisions

The AFL-CIO welcomes the inclusion of the Bingaman-Specter provisions on international trade within ACSA, providing a means to impose emission offset requirements on imported goods from major international trading partners that have not taken comparable action to protect the global climate. However, the language needs refinement. Implementation can and should take place far sooner than 2020.

The bill should require the President to open negotiations immediately upon passage. Once the regulations are in place and the cap and trade is in operation for two to three years, the international action can be implemented. This last step should be an administrative action, not something subject to presidential waiver.
In addition, the timetable and goals should be tied to the international language in S. 2191. It is now even more apparent than it was when the Kyoto Accord was negotiated that taking unilateral steps is not enough to engage the developing world. The Committee should include the five-year review provision included in Section 501 of S. 1766, with its requirement for presidential reviews and recommendations related to progress in international negotiations seeking commitments from major trading partners:

Presidential Recommendations to Congress. Subsection (b) provides that, during a period between April 15, 2017 and May 31, 2017, and every 5 years thereafter, the President shall submit to the House of Representatives and the Senate a report describing

any recommendation of the President with respect to changes in the Act. The President shall make recommendations with respect to—

> Whether the U.S. should change the allowance amounts for future allocation periods as necessary to ensure that the United States is undertaking its equitable share of the responsibility for reducing greenhouse gas emissions, and in any case will reasonably lead the United States to reduce its annual emissions to levels at least 60 percent below current emission levels by 2050.

Offsets and International Allowances

We are concerned about the legitimate use of offsets and international allowances; the ability to monitor their legitimacy, especially in the international market; and ways in which they could undermine domestic investment in industry. This proposal allows for up to 30 percent of the annual allowances that a covered entity must submit to be comprised of offsets (15 percent) and internationally purchased allowances (15 percent).

If the goal of this legislation is to change the behavior of domestic power producers and industry and to encourage the domestic investment needed to introduce new technology, this could prove to be a roadblock. One option is to limit their use in combination, or simply to lower the amount.

The expanded forestry/agriculture allowances under S. 2191 raise a broader question over potential double dipping with later offset provisions in the bill. For example, Oregon and other states already provide tax incentives for tree planting. In addition, the wood products industry is under legal and business obligations to plant trees year round. Will the offset provisions doubly reward already-existing behavior that has been backed by tax incentives or existing business imperatives? If a utility company helps underwrite a timber firm's required replanting of a logged area, could they then claim offset credits?

This simple example shows how existing tax incentives and business requirements could be used to create offsets that do not provide real value added to the environment. Offsets should be the result of creating something new or in addition to what normally would have been doe as a course of business. The ability to double dip should be prohibited.